

CERTIFIED FINANCIAL PLANNER BOARD OF STANDARDS, INC.

ANONYMOUS CASE HISTORIES
NUMBER 24481

This is a summary of a decision issued following the February 2011 hearings of the Disciplinary and Ethics Commission (“Commission”) of Certified Financial Planner Board of Standards, Inc. (“CFP Board”). The conduct at issue in this case occurred prior to January 1, 2009. The Rules in effect at that time under the *Code of Ethics and Professional Responsibility* (“Code of Ethics”) were Rules 101 through 705.

I. Issue Presented

Whether a CFP® professional (“Respondent”) violated CFP Board’s *Standards of Professional Conduct* when he recommended that his unaccredited client with limited assets invest over half her assets in an illiquid investment that required investor accreditation.

II. Findings of Fact Relevant to the Commission’s Decision

In 2007, Respondent entered into an investment advisory agreement with his client, an 86-year-old widow. The client sought Respondent’s advice to invest \$260,000 in proceeds received from a reverse mortgage. Respondent determined that his client’s investment objectives were to offset inflation and produce income.

Respondent recommended that his client invest \$140,000 in a fund whose business model was focused on short-term bridge loans to facilitate real estate entitlement, development and interim financing. Investors in the fund were required to invest a minimum of \$50,000 and be accredited investors as defined by Rule 501 of Regulation D of the Securities Act of 1933. The Rule 501 requirements for an individual are either a net worth in excess of \$1 million or income exceeding \$200,000 in the two most recent years. The fund lacked liquidity. There were restrictions on the ability of the units to be sold, transferred, or redeemed. The units were only redeemable upon the discretion of the fund’s Board of Directors. The investment objectives of the fund were to produce revenue from the interest income on the mortgage loans, provide monthly earnings and cash distributions to investors, and preserve and return capital contributions.

The rest of the client’s money was placed in a balanced portfolio of stocks, bonds, commodities, absolute return strategies and real estate. Respondent said that his client started withdrawing more money than she indicated to Respondent that she was planning to withdraw. Respondent said these unexpected withdrawals caused him to sell her holdings sooner than he had planned. Respondent also said that he cautioned his client against withdrawing more than she had originally intended because she would run out of money before she wanted to.

In October 2008, the fund’s Board of Directors suspended redemptions of fund units. A few months later the fund stopped paying dividends. In January 2010, Respondent’s client filed a

Complaint with the state superior court alleging statutory securities fraud, breach of the state Investment Management Act, negligent misrepresentation, negligence, breach of contract, and breach of fiduciary duty. Respondent's client claimed that the fund recommendation was unsuitable because fund units were illiquid and high risk securities. In his February 2010 letter to CFP Board, Respondent acknowledged that his client was an unsophisticated investor and that he should not have recommended the fund to her as an investment. In February 2010, the client accepted Respondent's offer to settle the lawsuit in which Respondent agreed to purchase his client's fund units for \$110,500.

III. Commission's Analysis and Conclusions Regarding Rule Violations

A. *Rule 102 - In the course of professional activities, a CFP Board designee shall not engage in conduct involving dishonesty, fraud, deceit or misrepresentation, or knowingly make a false or misleading statement to a client, employer, employee, professional colleague, governmental or other regulatory body or official, or any other person or entity.*

The Commission found that Respondent recommended that his 86-year-old client purchase \$140,000 worth of a fund. The client had \$260,000 in assets available for investment from a reverse mortgage and was not an accredited investor. The fund was high risk, illiquid, and unsuitable for the client. Respondent acknowledged that the client was an unsophisticated investor and that he should not have recommended the fund to her. By knowingly making an unsuitable recommendation to a client, Respondent engaged in conduct involving dishonesty, fraud, deceit or misrepresentation, or knowingly made a false or misleading statement to a client. Thus, Respondent violated Rule 102.

B. *Rule 201 - A CFP Board designee shall exercise reasonable and prudent professional judgment in providing professional services.*

The Commission found that Respondent recommended that his 86-year-old client purchase \$140,000 worth of a fund. The client had \$260,000 in assets available for investment from a reverse mortgage and was not an accredited investor. The fund was high risk, illiquid, and unsuitable for the client. Respondent acknowledged that the client was an unsophisticated investor and that he should not have recommended the fund to her. By making an unsuitable recommendation to a client, Respondent did not exercise reasonable and prudent professional judgment in providing professional services. Thus, Respondent violated Rule 201.

C. *Rule 606(b) - In all professional activities a CFP Board designee shall perform services in accordance with the applicable rules, regulations and other established policies of CFP Board.*

The Commission found that Respondent recommended that his 86-year-old client purchase \$140,000 worth of a fund. The client had \$260,000 in assets available for investment from a reverse mortgage and was not an accredited investor. The fund was high risk, illiquid, and unsuitable for the client. Respondent acknowledged that the client was an unsophisticated

investor and that he should not have recommended the fund to her. By making an unsuitable recommendation to a client, Respondent violated *Code of Ethics* Rules 102, 201 and 607, and thus failed to perform professional services in accordance with the applicable rules, regulations and other established policies of CFP Board. Thus, Respondent violated Rule 606(b).

D. Rule 607 - A CFP Board designee shall not engage in conduct which reflects adversely on his or her integrity or fitness as a CFP Board designee, upon the marks, or upon the profession.

The Commission found that Respondent recommended that his 86-year-old client purchase \$140,000 worth of a fund. The client had \$260,000 in assets available for investment from a reverse mortgage and was not an accredited investor. The fund was high risk, illiquid, and unsuitable for the client. Respondent acknowledged that the client was an unsophisticated investor and that he should not have recommended the fund to her. By making an unsuitable recommendation to a client, Respondent engaged in conduct that reflects adversely on his integrity and fitness as a CFP Board designee, upon the marks, and upon the profession. Thus, Respondent violated Rule 607.

IV. Discipline Imposed

Article 3(a) of CFP Board's *Disciplinary Rules and Procedures* ("Disciplinary Rules") provides grounds for discipline for any act or omission that violates the *Code of Ethics*. The Commission found grounds for discipline under Article 3(a) because Respondent violated Rules 102, 201, 606(b) and 607 of the *Code of Ethics*. Pursuant to Article 4.2 of the *Disciplinary Rules*, the Commission issued the Respondent a Public Letter of Admonition.

The Commission considered as mitigating factors that:

1. The sale of the fund was not commission-motivated.
2. Respondent refunded fees and bought the illiquid private placement back from the client as a result of the settlement of a civil suit.
3. Respondent was contrite and accepted full responsibility for the conduct.
4. The client's daughter may have been pushing for the client to take excess distributions.

The Commission considered as aggravating factors that:

1. Respondent purchased the fund units from the client at a discounted price, not making the client whole.
2. The client was 86 years old.
3. The initial income distribution of the portfolio was 9.6%, which was far too high.

V. Appeals Committee Decision

Respondent appealed the Commission's decision. The Appeals Committee affirmed the Commission's factual findings and discipline.